# The Weekly Market View

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بنك أبوظبي التجاري
ADCB

## Bond rout not over, equities relatively resilient

*The normalization of European bond yields is not over. Last week's rise in European bond yields again spilled over to US Treasuries and also determined a correction in global equity markets, limited in the US and most of Asia, stronger in Europe and especially India. GCC markets did by-and large well, in spite of the oil price losing ground. Commodity prices in general remained under pressure. Risk indicators, such as the VIX Index and Sovereign CDS, continue to indicate that markets do not believe in a Greek default and exit out of the Euro-zone. Strong US labour market data has increased speculation that the Fed might yet hike rates this years, determining – towards the end of the week – a firming of the US dollar.*


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## Little important data this week, US dollar likely to remain strong

*All in all we have seen more positive than negative data coming out last week. This is likely to keep up speculation that the Federal Reserve might hike rates in October. It should determine further upward pressure on the US dollar. It is less likely that yields will continue their upward surge, More than anything else we have seen a rise in the volatility following a temporary situation of overbought (mainly European) bonds. It is difficult to foresee exactly when that volatility will subside, but yields are unlikely to rise much more from current levels. We expect equity markets to remain volatile. European equity markets have currently the largest upside potential pending a solution of the Greek debt issue.*


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## Past week global markets' performance

**Index Snapshot (World Indices)**

| Index | Latest | Weekly Chg % | YTD % |
|---|---|---|---|
| S&P 500 | 2,092.8 | -0.7 | 1.6 |
| Dow Jones | 17,849.5 | -0.9 | 0.1 |
| Nasdaq | 5,068.5 | -0.0 | 7.0 |
| DAX 40 | 11,197.2 | -1.9 | 14.2 |
| Nikkei 225 | 20,460.9 | -0.5 | 17.2 |
| FTSE 100 | 6,804.6 | -2.6 | 3.6 |
| Sensex | 26,768.5 | -3.8 | -2.7 |
| Hang Seng | 27260.2 | -0.6 | 15.5 |
| **Regional Markets (Sunday to Thursday)** | | | |
| ADX | 4587.2 | 1.6 | 1.3 |
| DFM | 4032.2 | 0.8 | 6.8 |
| Tadaw ul | 9668.1 | -0.9 | 16.0 |
| DSM | 12092.3 | 1.6 | -1.6 |
| MSM30 | 6462 | 1.1 | 1.9 |
| BHSE | 1367.1 | 0.1 | -4.2 |
| KWSE | 6323.8 | 0.1 | -3.2 |
| **MSCI** | | | |
| MSCI World | 1,760.4 | -1.1 | 3.0 |
| MSCI EM | 982.1 | -2.2 | 2.7 |

**Global Commodities, Currencies and Rates**

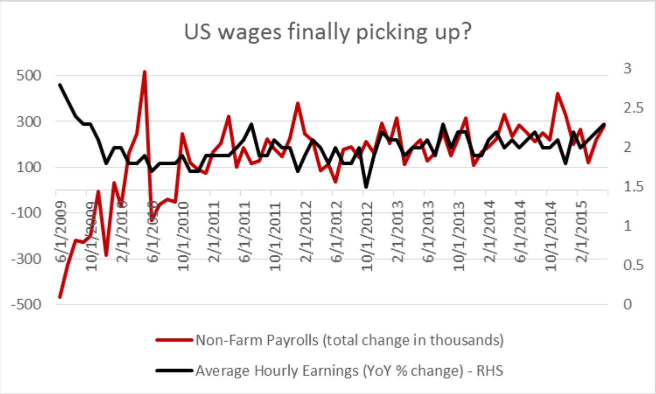
| Commodity | Latest | Weekly Chg % | YTD % |
|---|---|---|---|
| ICE Brent USD/bbl | 63.3 | -3.4 | 10.4 |
| Nymex WTI USD/bbl | 59.1 | -1.9 | 11.0 |
| OPEC Baskt USD/bbl | 59.7 | -1.3 | 14.8 |
| Gold 100 oz USD/t oz | 1171.9 | -1.6 | -1.0 |
| Platimum USD/t oz | 1096.4 | -1.4 | -9.2 |
| Copper USD/MT | 269.3 | -1.3 | -4.7 |
| Alluminium | 1716.75 | 0.5 | -6.4 |
| **Currencies** | | | |
| EUR | 1.1114 | 1.2 | -8.1 |
| GBP | 1.5270 | -0.1 | -2.0 |
| JPY | 125.63 | 1.2 | -4.7 |
| CHF | 0.9397 | -0.1 | 5.8 |
| **Rates** | | | |
| USD Libor 3m | 0.2789 | -1.7 | 9.1 |
| USD Libor 12m | 0.7480 | -0.2 | 18.9 |
| UAE Eibor 3m | 0.7386 | 0.0 | 9.1 |
| UAE Eibor 12m | 1.0671 | 0.0 | 5.1 |
| US 3m Bills | 0.0153 | 136639.5 | -56.9 |
| US 10yr Treasury | 2.4076 | 13.5 | 10.9 |

*Please refer to the disclaimer at the end of this publication*

# US monetary policy normalization will be enough to lift the US dollar, not yields

## Pick-up in US labour market increases chance of a Federal Reserve rate hike this year

Following a very sluggish winter, we have now seen for the second week in a row, more positive economic data coming out of the United States. To the pick-up in durable goods orders, and an apparently improving house market, we can now add the creation of 280'000 jobs in May and, albeit very gradually, some further rise in wages. The combination of a market which consistently continues to create jobs, together with finally some firming of wage growth, has inevitably increased speculation that the Federal Reserve will raise rates before year end.




This is first and foremost obvious in the futures markets which is now pricing the probability of an October rate hike at 50%, up from 43% last week. It was also obvious from the direction of the US dollar, as the greenback recovered significant losses against the currencies of all its trading partners, following the announcement of the positive labour market data. US government bond yields also continued to rise, such that the US 10 year Treasury yield surged almost 30 basis points during last week.

## The rise in bond yields is less likely to be sustained

It is important to point out, however, that the bulk of last week's rise in US Treasury yields had in fact materialized before the Friday announcement of a stronger-than-expected labour market. The rise in US yields seems therefore more the result of external factors, and in particular the recent rout in German Government bonds, than the result of a change in how the market views the US economic fundamentals, specifically the country's prospective growth and price dynamics.

It makes therefore sense to try to understand the recent jump in European yields, and in particular the fact that – since April 29 – German 10 year yields have jumped from a record low 5 basis points to approximately 80 basis points.

## European yields returning to normality

One way to better understand the recent surge in bond yields, is by looking at its implications across global financial markets. What most strikes the eye is that – since German government bonds initiated the upward yield spiral on April 29 – most equity markets have held up quite well. In fact, leaving aside some specific emerging markets, many equity markets are still at or above the level they were that day. This tells us that bond markets were still in overbought territory and only the most overcrowded trades, such as German equities, have somewhat – but not too much – corrected with bonds.

What matters more is that the growth and price dynamics in the Euro-zone remains rather muted, and that Mr. Draghi is likely to keep on buying Euro-zone Government bonds until September 2016, and he will likely do so at a rate that is double that of the rate at which Governments issue them.

Thus the most important recent pull factor of US yields – the recent rise in Euro-zone yields – is likely to subside soon. What's more, US yields are still significantly higher than Euro-zone yields. Prospective US dollar strength, likely with continuing weak commodity and energy prices and an increasing tightening bias by the Fed, will make that yield differential more attractive. Thus US government bonds will remain attractive and their yields should have reached a plateau.

This is not to say that we will not see more volatility going forward. Volatility, however, can go in more directions: if – later this month, or already next week - tensions rise regarding a possible exit of Greece out of the Euro-zone, the only yields to rise would be Greek bond yields.

## Summary market outlook

| | |
|---|---|
| **Global Yields** | An intensification of the rout of European, specifically German, bonds pushed global yields once more up. The US Treasury yield increased by close to 30 basis points. The better-than-expected US labour market data kept the pressure on yields as the week came to an end on Friday and markets increased speculation that the Federal Reserve may yet hike rates come October. We expect yields to subside this week as there will be little economic data. It is also possible that tensions regarding Greece might determine some flight to quality to both US Treasuries and German Bunds. |
| **Stress and Risk Indicators** | The VIX index stabilized as did most sovereign CDS spreads, with the exception of Greece. Markets keep on betting that the Greek issue will be solved. In case not, even if the immediate impact on other European countries should be manageable, we would expect a short-term rise in stress indicators across the board. |
| **Precious Metals** | Precious metals remain under pressure, as the US dollar profits from increased expectations of a rate rise. |
| **Local Equity Markets** | GCC equities did reasonably well last week, in spite of the oil price coming off again. This might be a sign that the oil price has found a more stable level and that the local equity markets' prospects can now gradually decouple from it. |
| **Global Equity Markets** | Global equity markets came down last week both as a result of the hike in government bond yields and increasing speculation that the Federal Reserve might yet hike rates this year. European and Indian equity markets suffered most. Next we would expect some recovery as yields should stabilize in the absence of major economic news. What could yet further derail markets is truly bad news on the Greek debt negotiations, i.e. default and exit. |
| **Energy** | The significant gains in energy prices are now being undone in view of the global growth slowdown, as well as the stronger US dollar. |
| **Industrial Metals** | The recent rally in commodities has now by and large been undone in view of continuing slow growth in China |

| **Currencies** | **Commentary** | **Critical levels** |
|---|---|---|
| **EURUSD** | The surge in European yields has pushed the euro higher against the US dollar. Towards the end of the week the Greenback regained significantly as the US labour market did better than expected and speculation rose as to the Fed hiking rates before the end of the year. We would expect some of this upside pressure on the US dollar to continue this week. | R2 - 1.1620<br>R1 - 1.1367<br>S1 - 1.0874<br>S2 - 1.0634 |
| **GBPUSD** | The US dollar remained largely unchanged against the British Pound Sterling. We are not expecting major moves as both central banks seem aligned in terms of policy timing. Some strengthening of the US dollar is possible as the Greenback will remain strong versus the euro and other currencies. | R2 - 1.5564<br>R1 - 1.5294<br>S1 - 1.5147<br>S2 - 1.5042 |
| **USDJPY** | We expect also further US dollar strength against the Japanese yen, as the Bank of Japan governor continues to make extremely dovish declarations, indicating that he is quite happy with further yen weakness. | R2 – 127.18<br>R1 – 126.41<br>S1 – 124.31<br>S2 – 122.98 |

# Forthcoming important economic data

## United States

| | Indicators | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 06/09/2015 | Wholesale Inventories MoM | Apr | 0.2% | 0.1% | Retail Sales to attract most attention as markets query whether consumption pace keeping up |
| 06/11/2015 | Retail Sales Advance MoM | May | 1.2% | 0.0% | |
| 06/11/2015 | Import Price Index MoM | May | 0.9% | -0.3% | |
| 06/12/2015 | PPI Final Demand MoM | May | 0.4% | -0.4% | |
| 06/12/2015 | University Michigan Confidence | June P | 91.4 | 90.7 | |

## Japan

| | Indicators | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 06/07/2015 | BoP Current Account Balance | Apr | ¥1687.4B | ¥2795.3B | Markets to focus on inflation (PPI) and industrial production |
| 06/09/2015 | PPI YoY | May | -2.2% | -2.1% | |
| 06/12/2015 | Industrial Production MoM | Apr F | | 1.0% | |

## Euro zone

| | Indicators | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 06/12/2015 | Industrial Production SA MoM | Apr | 0.4% | -0.3% | Industrial Production to confirm cyclical recovery |

## China and India

| | Indicators | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 06/07/2015 | China Exports YoY | May | -4.4% | -6.4% | China Money Supply growth and India and China Industrial Production growth to attract most attention |
| 06/07/2015 | China Imports YoY | May | -10.0% | -16.2% | |
| 06/08/2015 | China CPI YoY | May | 1.3% | 1.5% | |
| 06/08/2015 | China PPI YoY | May | -4.5% | -4.6% | |
| 06/09/2015 | China M2 Money Supply YoY | May | 10.5% | 10.1% | |
| 06/09/2015 | India Exports YoY | May | | -14.0% | |
| 06/09/2015 | India Imports YoY | May | | -7.5% | |
| 06/11/2015 | China Industrial Production YoY | May | 6.0% | 5.9% | |
| 06/12/2015 | India Industrial Production YoY | Apr | | 2.1% | |

## Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTTNews
4. Reuters
5. Gulfbase
6. Zawya

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